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SUBJECT: FINANCE SECRETARY OUTLINES GSL DEVELOPMENT PLANS

Classified By: Ambassador Butenis for Reasons 1.4 (B, D)

¶1. (SBU) Summary. Influential powerbroker P.B. Jayasundera has returned to the government as the Finance Secretary, following a year-long exile due to corruption issues. In an introductory call with Ambassador Butenis, Jayasundera described government plans to reconstruct the North and East that include a role for foreign investors. Jayasundera commented that the global financial crisis had had a moderate impact on Sri Lanka. Sri Lanka plans a major reform of its tax structure, which is also required to fulfill an IMF target. Finally, Jayasundera opined that the recent arrest in the United States of Raj Rajaratnam for insider trading will have not have a great impact on the Sri Lankan economy. End Summary.

Background on Finance Secretary Jayasundera

¶2. (C) Jayasundera is a key economic advisor to President Rajapaksa, and Rajapaksa pushed to bring Jayasundera back after a corruption scandal. President Rajapaksa serves as his own Finance Minister, but Secretary Jayasundera is the power behind the throne. Jayasundera has real influence with President Rajapaksa and serves as the President's chief troubleshooter on financial matters. His exile from public service followed his actions during the privatization of Lankan Marine Services, when Jayasundera was alleged to have used his influence to lower the price paid by the local conglomerate John Keells Holdings for the public monopoly Lanka Marine Services. In October 2008, Jayasundera was fined 500,000 rupees (approximately \$4,400 USD), and forced to file a motion before the Sri Lankan Supreme Court agreeing to never serve in public office again. After the resignation of the prior Supreme Court Justice, Jayasundera filed a motion to withdraw his promise never to serve in public office. The Supreme Court eventually ruled that Jayasundera could withdraw from his promise, and President Rajapaksa immediately reappointed Jayasundera to be his Finance Secretary.

Reconstruction Plans for the Conflict Areas

¶3. (SBU) Jayasundera stated that President Rajapaksa had outlined his 10 year development plan during his 2005 election campaign. Jayasundera said that the GSL plans to continue its 30 year policy of welcoming the private sector, and the GSL would pursue the same policies for foreign investors to encourage trade. The GSL plan placed a high priority on rebuilding the North and East, and the GSL looked to donors such as the World Bank, Asian Development Bank and others to fund infrastructure to spur reconstruction. In

particular, Jayasundera emphasized the importance of developing Sri Lanka's ports (as regional transportation hubs) and power generation. Ambassador Butenis raised the issue of how bilateral political tensions could impact donations for reconstruction. The Ambassador cited the issues of human rights during the final phase of the war and the GSL holding internally displaced persons in closed camps. Jayasundera said that the GSL was engaging with the European Union on the issue of IDP camps.

Global Financial Crisis had a Moderate Impact on Sri Lanka

14. (SBU) Jayasundera asserted that the global financial crisis had inflicted a limited impact on Sri Lanka. Jayasundera acknowledged that government revenue and exports of garments and rubber had declined significantly in the first half of 2009. Sri Lanka's treasury had controlled expenses, he claimed, so the lost foreign revenue had less impact. Moreover, the trade losses were partially compensated by lower fuel costs. Sri Lanka imports all of its fuel, and the world wide reduction in oil prices lowered Sri Lanka's cost of oil imports. Jayasundera also said that the IMF package helped contain investor worries about the Sri Lankan economy. (Note: Jayasundera breezed over how the GSL was forced to negotiate for an IMF package last spring and summer as their foreign exchange reserves reached dangerously low levels. End Note.) Jayasundera thought that the world economy was improving, particularly in Asia, which should lift the Sri Lankan economy.

Fiscal Reform Plans

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15. (SBU) The GSL is determined to simplify its tax structure and increase its tax collections. The GSL has appointed a Presidential Commission comprised of bankers, the private sector and public officials. The Commission is working on reforming the tax code, not only to make it more transparent with fewer taxes, but also to significantly increase tax collections. Jayasundera wants to focus on income and corporate taxes, customs duties, value added tax, and excise taxes. The GSL also plans to reduce the number of tax holidays for foreign investors if these benefits do not prove necessary to attract foreign direct investment. (Note. Under the IMF agreement, the GSL has a target to increase tax collections by 2% of GDP by 2011, an ambitious goal. End Note.)

Billionaire Arrest Will Not Undermine Sri Lankan Economy

16. (SBU) Sri Lanka has been buzzing about the arrest in the United States of Raj Rajaratnam for insider trading. Rajaratnam is a Sri Lankan native who founded the Galleon hedge fund, became a billionaire and pledged money to help rebuild Sri Lanka. Ambassador Butenis clarified that our information indicated that Rajaratnam was arrested for insider trading, not for activities related to LTTE funding or any Sri Lankan issue. Jayasundera thought that the market was overreacting to the arrest, and argued that the market fundamentals were still strong. Jayasundera did think that the regulatory authorities needed to review investment flows to review Rajaratnam's Sri Lankan investments. (Note. The Colombo Stock Exchange fell by over 3% on October 20 after the arrest and the European Union recommendation to revoke GSP plus trade benefits. According to press reports, Rajaratnam held up to 9% of the stock of a leading local conglomerate John Keells Holdings, and in general he reportedly held 1.3% of the market capitalization of all Sri Lankan equities. End Note.)

17. (C) Comment. Jayasundera is intelligent and well educated, with a doctorate in Economics from Boston University. Post had heard reports that Jayasundera was nationalist and could be difficult for foreign investors. However, Jayasundera knew his audience and came off as

reasonable, and he specifically described a role for foreign investment in Sri Lanka,s reconstruction. The GSL has increasing turned to new friends such as China and Iran, and there has been much public criticism of the United States and the West in government newspapers. Post will send septel an analysis of how the GSL makes economic policy. End Com
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